No. 15797

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARC D. LEH and L. WAIVE LEH,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DAVID E. BROWN and CHRISTOBEL H. BROWN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

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PETITIONERS' OPENING BRIEF.

Statement Regarding Jurisdiction.

These are petitions to review decisions of the Tax Court. The United States Courts of Appeals have exclusive jurisdiction to review decisions of the Tax Court with an exception not applicable here. (Int. Rev. Code of 1954, Sec. 7482.) Venue lies in the Ninth Circuit, inasmuch as the office to which was made the return of the tax in respect of which the liability arises is located in the Ninth Circuit. [Int. Rev. Code of 1954, Sec. 7482; R. 5, 11, 18, 21.]

Statement of the Case.

The Commissioner of Internal Revenue issued notices of deficiency in federal income tax against petitioners for the taxable year 1950. Petitioners filed timely petitions with the Tax Court to redetermine and eliminate the deficiencies in both cases. Petitioners in the *Leh* case also prayed for a refund[1] of $2,475.62. [R. 4, 7, 18, 20.]

All issues raised by the pleadings except the capital gain issue were settled by stipulation of the parties.

The capital gain question, the sole issue in this case, is whether the amount of $183,330.50 received by the petitioners' partnership, The Progress Company, from Olympic Refining Company, a corporation, in 1950 is taxable as capital gain or ordinary income.

The Commissioner of Internal Revenue determined that such amount was taxable as ordinary income, and the Tax Court sustained the determination. (*Leh v. Commissioner,* 27 T. C. 892 (No. 110).) Accordingly, the Tax Court ordered and decided that there was a deficiency of $20,308.88 for 1950 in the *Leh* case and a deficiency of $21,403.52 in the *Brown* case. [R. 36, 37.]

Petitioners seek review of those decisions.

The cases were consolidated in the Tax Court [R. 3] and are being heard together on a single record on this appeal.

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[1]If the Tax Court finds that there is an overpayment rather than a deficiency, it has jurisdiction to order a refund. (Internal Revenue Code of 1954, Sec. 6512(b).)

Specification of Error.

It is the position of petitioners that the Tax Court erred in finding that the $183,330.50 received in 1950 did not represent gain from the "sale or exchange" of property taxable as long-term capital gain under Section 117 of the Internal Revenue Code of 1939. The Tax Court could find no sale or exchange and hence no capital gain result. It saw in the contract of 1950 simply an extinction of contractual rights rather than a *transfer* of them. [R. 35.] The error is that the Tax Court failed to do two things: (1) To analyze correctly what the parties did as a matter of law; and (2) to recognize that there was simply a mislabeling here. A "cancellation" was actually a *transfer* of rights from The Progress Company to Olympic Refining Company—a transfer by reason of which Olympic received rights (property, though intangible) which it did not own before the transaction (rights to possess, use or resell a supply of gasoline). The only "extinction," "cancellation" or "termination" lay in the result that, common to every sale or exchange, the transferor parts with something and thereafter does not have it.

Summary of Argument.

In summary form, petitioners' argument is as follows:

In 1945 Olympic Refining Company entered into a supply contract with General Petroleum Corporation under which Olympic was entitled to buy and resell 3,500,000 gallons of General Petroleum gasoline per month at specified prices. [Jt. Ex. 1-A.] In 1948 Olympic, in turn, entered into a supply contract with The Progress Company, a partnership of which petitioners Marc D. Leh and David E. Brown were members. In the latter contract, the General Petroleum contract was incorporated by reference and provision was made that The Progress Company was to be entitled to buy and resell 2,250,000 of the 3,500,000 gallons of gasoline being supplied by General Petroleum per month. [Jt. Exs. 4-D and 5-E.] In a sense Progress was given the right of first refusal of the General Petroleum gasoline.

In 1950, The Progress Company received the $183,-330.50 which is at issue in this case from Olympic for the "termination" of the 2,250,000 gallon supply contract. [Jt. Ex. 8-H.]

All the requirements of Section 117 of the Internal Revenue Code of 1939, 26 U. S. C. A., Sec. 117, have been met in that the contract rights of The Progress Company were "property," "held for more than 6 months," which was depreciable and used in the trade or business, and which was the subject of a "sale or exchange" in 1950. (Par. (3) of Argument in this brief below.)

The Tax Court erred in finding that there was no "sale or exchange."

There is a "sale" where there is a transfer of property for cash. Property includes intangible rights. (Par. (4)(a) of Argument.)

The fact that the 1950 transaction was labelled a "termination" is not determinative that it was not a sale. (Par. (4)(b) of Argument.)

Petitioners' position is supported by decision in the Second, Third, Fifth and Tenth Circuits. (Par. (4)(c) of Argument.)

The property which was transferred from The Progress Company to Olympic in 1950 was the exclusive right freely to possess, use, resell or otherwise deal with 2,250,000 of the 3,500,000 gallons of gasoline per month being supplied by General Petroleum. (Par. (4)(d) of Argument.)

The Tax Court misconceived the property rights involved in this case. (Par. (4)(e) of Argument.)

From the standpoint of economic realities, the property which was transferred in 1950 were rights of ownership and dominion over a monthly supply of up to 2,250,000 gallons of General Petroleum gasoline. (Par. (4)(f) of Argument.)

The decision below should, therefore, be reversed.

ARGUMENT.

(1) The Statute.

The statute involved in this case is Section 117 of the Internal Revenue Code of 1939, 26 U. S. C. A., Sec. 117, which relates to capital gains and losses.

The pertinent portions thereof are quoted in the Tax Court's opinion, set forth in the Record at pages 30 and 31 and are cited in the footnote herein.[2]

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[2]Section 117. Capital Gains and Losses.

* * *

(j) Gains and Losses From Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.—

(1) Definition of Property Used In the Trade or Business.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in subsection (a)(1)(C). * * *

(2) General Rule.—If. during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *

(2) The Facts.

The Tax Court made certain Findings of Fact. The findings are set forth in the Record at pages 24 to 30, and are incorporated herein by reference.

Petitioners make no exceptions to the correctness of those findings as far as they go. The Tax Court did err, however, in failing to make an additional finding of mixed fact and law that there was a "sale" in this case.

For purposes of convenience the Findings of Fact are referenced to the Record in the table in Appendix B.

(3) Requirements of the Statute and the Question.

Section 117(j) of the Internal Revenue Code of 1939 [R. 30, 31] provides that gain is to be taxed at long-term capital gain rates where the following elements are present:

(a) There is a "sale or exchange";

(b) Of "property";

(c) Which has been "used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1)";

(d) And which has been "held for more than 6 months."

The "property" involved is the exclusive contract right to buy and freely to resell or otherwise deal with certain General Petroleum products acquired by The Progress Company under two letter agreements between the Progress Company and Olympic Refining Company dated January 28, 1948. [Jt. Exs. 4-D and 5-E.]

Such contract rights are "property" within the meaning of Section 117. "'Property' is a word of very broad meaning, and when used without qualification, expressly

made or plainly implied, it reasonably may be construed to include obligations, rights and other intangibles as well as physical things." (*Fidelity & Deposit Co. v. Arenz,* 290 U. S. 66, 68 (1933), (bankruptcy case).) See also, *Lynch v. Alworth-Stephens Co.,* 267 U. S. 364, 369 (1925), (federal income tax case) and *Commissioner v. Ray,* 210 F. 2d 390 (5th Cir., 1954), *cert. denied* 348 U. S. 829 (1954), (federal income tax case involving Sec. 117).

The Tax Court found or inferred (and, petitioners submit, correctly) that the property was depreciable property used in the business and held for more than six months.[3]

The sole remaining question is whether the Tax Court erred in finding that there was no "sale or exchange" within the meaning of Section 117 of the Internal Revenue Code.

(4) There Was a "Sale or Exchange" in This Case.

(a) Definition of "Sale."

In *Rogers v. Commissioner,* 103 F. 2d 790 (9th Cir., 1939), the Court of Appeals for the Ninth Circuit had occasion to consider the meaning of the phrase "sale or

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[3]These property rights were "used in the trade or business" of The Progress Company in that The Progress Company bought petroleum products pursuant to its rights under the contract and resold the products in its business. [R. 52, 65-67.] And the contract rights were "subject to the allowance for depreciation provided in Section 23(1)," although no depreciation was allowable since the contract rights were created by an exchange of promises and had no cost for tax purposes. [R. 81.] (*Hickok Oil Corporation v. Commissioner,* 120 F. 2d 133 (6th Cir., 1941).)

The contract rights were held by The Progress Company continuously [R. 47] from January 28, 1948 [Jt. Exs. 4-D and 5-E] to July 26, 1950 [Jt. Ex. 8-H], and were therefore "held for more than 6 months."

exchange" in the capital gain section of the federal income tax statute. In holding that there was a "sale," and therefore a capital loss, where property was transferred in extinguishment of a mortgage debt, the Court adopted the following definition of the word "sale":

> "As defined by Iowa v. McFarland, 110 U. S. 471, 478, 4 S. Ct. 210, 214, 28 L. Ed. 198, 'A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent.' See, also, United States v. Benedict, 2 Cir., 280 F. 76, 80; Gallus v. Elmer, 193 Mass. 106, 78 N. E. 772, 8 Ann. Cas. 1067."

The definition was approved and followed by the Court of Appeals for the Fourth Circuit in *Gruver v. Commissioner,* 142 F. 2d 363 (4th Cir., 1944) (capital gain case), and by other courts.

There is no doubt that intangible property may be the subject of a sale or transfer and that the phrase "sale or exchange" in Section 117 embraces intangible as well as tangible property. (*Commissioner v. Golonsky,* 200 F. 2d 72, 74 (3d Cir., 1952), *cert. denied,* 345 U. S. 939.)

(b) That the Transaction Was Denominated a Termination or Cancellation and Was With Olympic and Not a Third Party Are Not Determinative That There Was No Sale.

In this case The Progress Company acquired its rights from Olympic Refining Company in the letter agreements of January 28, 1948 [Jt. Exs. 4-D and 5-E] and disposed of those rights to Olympic on July 26, 1950, by a contract called a "Mutual Termination Agreement" [Jt. Ex. 8-H] which contained language of termination, cancellation and release.

The fact that the transaction in 1950 was with Olympic rather than with a third party is not determinative whether there was a "sale."

In *Commissioner v. McCue Bros. & Drummond, Inc.*, 210 F. 2d 752 (2nd Cir., 1954), *cert. denied,* 348 U. S. 829, where a lessee received consideration from the lessor for vacating the premises the Court said:

> "If it [the lease] is sold by a tenant to a third person, the gain derived therefrom is a capital gain, Sutliff v. Commissioner, 46 B. T. A. 446, and we see no reason why a different result should be reached here." (210 F. 2d at p. 753.)

Similarly, in *Commissioner v. Goff,* 212 F. 2d 875 (3d Cir., 1954), where the exclusive right to the output of hosiery machines was relinquished to the other party to the contract, the Court said:

> "We do not see in principle how the person to whom a tangible right is transferred can affect the question whether the transfer is a sale or exchange." (212 F. 2d at p. 876.)

The fact that the Mutual Termination Agreement [Jt. Ex. 8-H] was cast as a settlement agreement and used such language as "cancel," "terminate," and "release" rather than words such as "sell" or "assign" is not determinative. The reasoning in *Commissioner v. Golonsky,* 200 F. 2d 72 (3d Cir., 1952), a capital gain case where the lessee surrendered the premises to the lessor, is in point:

> "Why then is a transfer of a leasehold interest by a tenant to a landlord not a 'sale?' To call the transaction a cancellation or termination of a lease and not a sale is, we think, to assume the point to be decided. Undoubtedly there is a cancellation of the

lease when the tenants voluntarily surrender the premises to a landlord in accordance with an agreement, but the fact that the cancellation occurs does not negative the fact that the transaction may constitute a sale." (200 F. 2d at p. 73.)

In *McAllister v. Commissioner,* 157 F. 2d 235 (2d Cir., 1946), *cert. denied,* 330 U. S. 826, the Court, in reversing the decision of the Tax Court that the beneficiary of a trust made no transfer or assignment when the agreement provided for a "termination," said:

> "But what is this more than a distinction in words? . . . There surely cannot be that efficacy in lawyers' jargon that termination or cancellation or surrender carries some peculiar significance vastly penalizing laymen whose counsel have chanced to use them. . . . What was practically accomplished remained the same." (157 F. 2d at p. 236.)

Whether there was a "sale" is thus not dependent upon the intent of the parties, as such, or their language—it depends upon whether there was a transfer of property for a consideration. In this case there was obviously little attention, if any, given to language or tax consequences.

(c) The Case Law on the Question of Transfer of Property Rights v. Extinguishment.

The Tax Court found that the $183,330.50 gain realized was not taxable as a capital gain because there was no "sale or exchange." It said that the rights of The Progress Company "merely came to an end and vanished" [R. 34], citing *Commissioner v. Starr Brothers, Inc.,* 204 F. 2d 673, 674 (2d Cir., 1953).

While petitioners' agree that the transaction of 1950 did have the effect of extinguishing the right of The Progress Company to performance and also of terminating the contract, this "does not negative the fact that the transaction may constitute a sale." (*Commissioner v. Galonsky,* 200 F. 2d 72, 73 (3d Cir., 1952).) A sale is consummated, as we have seen, when property is transferred by its owner for a stipulated price which is paid. In *Commissioner v. Starr Brothers, Inc.,* 204 F. 2d 673 (2d Cir., 1953), and *General Artists Corporation v. Commissioner,* 205 F. 2d 360 (2d Cir., 1953), *cert. denied,* 346 U. S. 866, which were cited by the Tax Court [R. 34-35], "no 'sale or exchange' within the meaning of the statute was found because the contractual right was not transferred, but was released and merely vanished." (*Commissioner v. McCue Bros. & Drummond, Inc.,* 210 F. 2d 752, 753 (2d Cir., 1954), *cert. denied,* 348 U. S. 829.)

Where, however, a contractual right is transferred for a valuable consideration and continues to exist as property of the transferee-payor, courts have consistently held that there is a "sale or exchange" and that any gain realized is a capital gain. *Commissioner v. Goff,* 212 F. 2d 875 (3d Cir., 1954) (Taxpayers, who had received from A the exclusive right to buy from A the hosiery produced by machines operated by A, assigned the rights to A. *Held,* the transaction was a "sale" and the proceeds were capital gain); *Commissioner v. Golonsky,* 200 F. 2d 72 (3d Cir., 1952), *cert. denied,* 345 U. S. 939 (Surrender by lessee of promises to lessor before lease expired. *Held,* a "sale" and capital gain.); *Commissioner v. Ray,* 210 F. 2d 390 (5th Cir., 1954), *cert. denied,* 348 U. S. 829 (Lessee released lessor from lessor's

covenant not to rent to a certain type of store. *Held,* a "sale" and capital gain); *Commissioner v. McCue Bros. & Drummond, Inc.,* 210 F. 2d 752 (2d Cir., 1954), *cert. denied,* 348 U. S. 829 (Consideration received by lessee from lessor to vacate the premises. *Held,* a "sale" and capital gain, distinguishing *Commissioner v. Starr Bros.,* 204 F. 2d 673 (2d Cir., 1953), and *General Artists Corporation v. Commissioner,* 205 F. 2d 360 (2d Cir., 1953), because of the existence of "a more substantial property right which does not lose its existence when transferred." (210 F. 2d at p. 753); *Jones v. Corbyn,* 186 F. 2d 450 (10th Cir., 1950); *Walter H. Sutliff,* 46 B. T. A. 446 (1942).

The *Goff* case, *supra,* involved the right to buy the entire output of four hosiery manufacturing machines, a right quite like the one in this case. Similarly, the *Golonsky* case, *supra,* involved the right of possession of property, as did the *Ray* and *McCue* cases, *supra.* There is little difference between the right of possession of real property, and the right of possession of General Petroleum gasoline.

(d) Summary of Facts in This Case That There Was a Transfer.

A summary of the facts in this case will bring out the similarity between it and the *Goff* and other cases cited.

By letter agreement dated January 28, 1948 [Jt. Exs. 4-D and 5-E] Olympic transferred to The Progress Company the right to purchase and resell 2,250,000 gallons of gasoline per month of the 3,500,000 gallons per month which General Petroleum was committed to supply. [Jt. Ex. 1-A.] Thus The Progress Company acquired a valuable right and interest in the General Petroleum

supply of gasoline. It retained this interest from January 28, 1948, to July 26, 1950. On the latter date Olympic paid The Progress Company $183,330.50 [Jt. Ex. 8-H] and in exchange therefor The Progress Company gave up its interest in the contract dated January 28, 1948. As the result of this transaction, Olympic acquired the exclusive right freely to possess, use, resell or otherwise deal with the 2,250,000 gallons per month. It could sell the gasoline to whomsoever it chose at whatever terms it could arrange. This is a right that it did not possess during the period January 8, 1948, to July 26, 1950. *The movement of that exclusive right from The Progress Company to Olympic was the transfer in this case.*

(e) The Tax Court Failed to Recognize Certain Property Rights Involved in This Case.

We submit that the Tax Court failed to recognize certain property rights involved in this case. The Tax Court admitted that its distinctions might not be "wholly satisfying." [R. 35.]

The Tax Court found that the contract between The Progress Company and Olympic Refining Company dated January 28, 1948, merely created a right on the part of Progress to acquire gasoline from Olympic. To quote from the opinion:

> "That contract gave Progress the right to have its gasoline requirements supplied by Olympic, and the evidence indicates that its purchases were made from Olympic. The General-Olympic contract was a separate and distinct transaction. . . ." [R. 32.]

How can it be said that the General-Olympic contract was "separate and distinct" when it was *incorporated by*

reference into the 1948 contract between Olympic and Progress [Ex. 4-D]!

Progress had more than just the right to buy gasoline from Olympic. It had the right buy part of a certain supply of *General Petroleum gasoline,*[4] and it had the *exclusive right to possess or use or freely to resell* that gasoline to whomsoever it chose at whatever terms it could arrange.

The property right which continued to exist both before and after the "termination" transaction in 1950 and was transferred in that transaction was, we submit, the exclusive right to possess or use or freely to dispose of the 2,250,000 gallons per month which General Petroleum was obligated to supply under the 1945 contract.

For tax purposes property has been defined as "legal relations between persons with respect to a thing." (*Commissioner v. Golonsky,* 200 F. 2d 72, 74 (3d Cir., 1952), *cert. denied,* 345 U. S. 939 (capital gain case).) The point just made may be better brought out by a closer examination of the legal relations in this case.

In 1945 Olympic entered into a supply contract with General Petroleum. [Jt. Ex. 1-A.] Under that contract, Olympic acquired the right to buy from General Petroleum up to a maximum of 3,500,000 gallons of its gasoline each month at certain prices. There were certain restrictions on resale prices and resale areas. [Jt. Ex. 1-A, p. 4, "General Terms."] Apart from those restric-

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[4]It cannot be overemphasized that the Olympic-Progress agreement of 1948 [Ex. 4-D] incorporated the Olympic-General Petroleum contract of 1945 [Ex. 1-A] by reference. It was General Petroleum's gasoline, and no one else's that was involved here. Progress even gave a release to General Petroleum in the 1950 transaction. [Ex. 8-H.]

tions, *Olympic also acquired the right to resell the entire 3,500,000 gallons to anyone* it chose at whatever prices it could get. There was no prohibition against assignment in the agreement.

The circumstances leading up to the agreement of 1948 between Olympic and The Progress Company [Jt. Exs. 4-D and 5-E] were explained by witness Harold J. Steitz, Vice President of Olympic, in charge of marketing, as follows:

> "Q. Could you now tell us briefly the business background leading to the execution of those letters that you have before you? A. Well, we had a supply contract from the General Petroleum Corporation which entitled us to take three and a half million gallons of gasoline per month, and I believe that we had been successful in marketing some million or million and a quarter, or some such figure as that. We were not taking the entire supply, and obviously, of course, we wished to sell it and gain the profit from it, and for that reason we made this contract with The Progress Company, Mr. Leh and Mr. Brown." [R. 102.]

The agreement of 1948 (January 28, 1948) between Olympic and The Progress Company is disarmingly simple. It consists of two letters [Jt. Exs. 4-D and 5-E] and contained the following provision:

> ". . . the terms, amendments, conditions and provisions [of the 1945 Olympic supply contract with General Petroluem] are incorporated herein by reference and made a part hereof to all intents and purposes as though the same were set forth in full. . . ." [Jt. Ex. 4-D.]

Petitioner Marc D. Leh, who signed the agreement on behalf of The Progress Company regarded it as "an assignment of part of General Petroleum's supply contract with the Olympic Refining." [R. 46.] Regardless of whether this is called a legal assignment of the right to buy 2,250,000 of the 3,500,000 gallons per month from General Petroleum, or an equitable assignment, or a right of first refusal, there can, however, be no question that Olympic gave up its exclusive right to possess or use or freely dispose of the 2,250,000 gallons per month which The Progress Company was entitled to buy, and that The Progress Company acquired the legal right to prevent Olympic from reselling that gasoline to another. This is clear from the provisions of the contracts themselves.

After the 1948 contract was entered into The Progress Company took delivery of the gasoline at the refinery of General Petroleum, and not at any facilities of Olympic. Olympic maintained no gasoline dump or terminal. [R. 83-84.] Nor did it have any refinery in operation. [R. 56.] The Progress Company went directly to General Petroleum for its gasoline and Olympic did not even arrange for pickup and delivery. [R. 102.]

Harold J. Steitz, Vice President of Olympic, testified, as follows:

> "Q. Mr. Steitz, did your company handle physically the gasoline that was sold to The Progress Company under those contracts? A. No, we did not. The gasoline was taken at the refinery of General Petroleum, which was our supply point.
>
> Q. Did you arrange for the pickup and delivery of that gasoline or not? A. No." [R. 102.]

The conduct of the parties is thus consistent with the existence of the exclusive right in The Progress Company freely to use or dispose of the gasoline and its nonexistence in the hands of Olympic after the 1948 contract.

Between the time of the 1948 contract and the 1950 "Termination" agreement the rights of The Progress Company became more valuable. This was the result of the short supply of gasoline which developed in Southern California between 1948 and 1950. [R. 64, 90-91, 99.] At the beginning of the contract in 1948 very little gasoline was purchased by Progress, but the amount increased progressively, and, by 1950, the full amount permitted was purchased. [R. 52.] The shorter the supply of gasoline, the more profits could be made from such a contract. [R. 58.] According to witness Jack N. Jessen, secretary of General Petroleum [R. 94], "in 1950 when practically all suppliers on the Pacific Coast were short of supply, any supply contract of a substantial amount would have quite a market value, in my opinion, at that particular time." [R. 99.]

The thing that became more valuable was not just the right to acquire General Petroleum gasoline at certain prices; it was the freedom to possess or use or to resell it to whomsoever the holder of that right chose on whatever terms it could arrange (subject to the restrictions on resale prices and areas set forth in the 1945 contract).

On July 26, 1950, The Progress Company received the $183,330.50 at issue in this case from Olympic Refining Company pursuant to the "Mutual Termination Agreement." [Jt. Ex. 8-H.]

The transaction can be described by paraphrasing the reasoning approved in *Commissioner v. Ray,* 210 F. 2d 390, 391, 392 (5th Cir., 1954), *cert. denied,* 348 U. S. 829. Before the 1950 "Mutual Termination Agreement" The Progress Company had a valuable property right, intangible but nonetheless property, a right to acquire and freely resell 2,250,000 gallons of General Petroleum gasoline per month. This imposed a "servitude" upon the 1945 Olympic-General Petroleum contract and prevented Olympic from freely reselling the 2,250,000 gallons. Before the 1950 transaction, which freed the 1945 Olympic-General Petroleum contract from this servitude, Olympic lacked a valuable right, the right to sell the 2,250,000 gallons per month to whomsoever it chose upon whatever terms it could arrange. True, Olympic had once possessed this right, but it had conveyed the right to The Progress Company in 1948. In the 1950 "Termination" Olympic gave its $183,330.50 to The Progress Company and in exchange The Progress Company gave to Olympic what it had not immediately theretofore possessed, the right to resell the 2,250,000 gallons per month of General Petroleum gasoline to whomever it chose at whatever terms it could arrange.

The Tax Court's position apparently depends upon a view that The Progress Company's rights when transferred or released to Olympic simply disappear, vanish and become nothing, and, therefore, cannot be the subject of a sale. The concept, it seems overlooks the substantial fact that it is the right freely to resell that is the subject of the transaction. Intangible though the property may be, it is real and valuable to both parties to the transaction: a right to acquire and freely resell General Petroleum gasoline and to prevent Olympic from reselling it

in the hand of The Progress Company, and a right to acquire and freely resell General Petroleum gasoline in the hands of Olympic. The Tax Court's view conceives the right of The Progress Company to acquire General Petroleum gasoline from Olympic as the thing and ignores the status of the right to resell freely as the substance of the sale.

In the view of the Tax Court property rights which disappear or vanish upon a relinquishment, surrender or termination cannot be the subject of a sale. The property rights of every seller can be said to cease, disappear or vanish in every sale. They are simply transferred to the buyer, who holds them himself. In this case the right freely to resell 2,250,000 gallons of General Petroleum gasoline did disappear or vanish on July 26, 1950, as far as The Progress Company was concerned, but it reappeared in the hands of Olympic. In other words, the right was transferred ("sold").

(f) Economic Realities.

Economic realities are not ignored in determining the incidence of the federal income tax. *Texas Trailercoach, Inc. v. Commissioner,* ...... F. 2d ......, 58-1 U. S. T. C. par. 9175 (5th Cir., 1958):

> "The closer a tax comes to giving effect to the economic realities, the more bearable it is as the price of national security and of civilization."

In the words of Justice Holmes in *Corliss v. Bowers,* 281 U. S. 376 (1930): ". . . taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed. . . ."

The "Mutual Termination Agreement" between The Progress Company and Olympic Refining Company was entered into on July 26, 1950. [Jt. Ex. 8-H.] Pursuant to that agreement Olympic paid $183,330.50 to The Progress Company and $31,669.50 to Olympic Progress Oil Co., a total of $215,000, which was divided between the two in the proportion to the quantities of gasoline to which each was entitled under their respective contracts. [R. 54, 77, 85-86.]

Five or six days later, on July 31, 1950, and August 1, 1950, Olympic and General Petroleum entered into agreements [Jt. Exs. 9-I and 10-J] under which $235,000 or $237,000 was paid by General Petroleum to Olympic [R. 93, 97], and the quantities under the original supply contract of 1945 [Jt. Ex. 1-A], namely, a maximum of 3,500,000 gallons of gasoline per month, were cut in half to 21,000,000 gallons per year or 1,750,000 gallons per month. [Jt. Ex. 9-I; R. 93.]

Witness Jack M. Jessen, secretary of General Petroleum and assistant counsel in the legal department, who had been with the company twenty-two years, and who drafted the agreements [R. 94-95], described the background and significance of that transaction as follows:

> "Q. Now, if you will, Mr. Jessen, will you describe briefly the business background and the significance of the transactions which is represented by these documents? A. Well, in 1950, when these various instruments were prepared, Mr. Butterworth of the marketing department advised that due to shortage of supply of General Petroleum Corporation, they were seeking other supplies, and in connection with that, they looked at their present

> existing contracts with buyers with the view of trying to repurchase some of that supply in order to relieve the shortage of supply the General Petroleum was faced with at that time." [R. 95-96.]

Although there can be no precision in the talking about "economic realities," we might approach economic reality by ignoring legal rights and looking only at the thing, as was done by Mr. Jessen. From that standpoint The Progress Company, Olympic Refining Company and General Petroleum Corporation were concerned with a concrete, tangible, thing which would come into existence in the future, namely, a supply of General Petroleum Corporation gasoline. From an economic standpoint it might be said that it was part of that supply which The Progress Company transferred to Olympic on July 26, 1950, for $183,330.50.

Viewed, then, from either a legal or an economic standpoint, substantial property rights were transferred by The Progress Company to Olympic for $183,330.50 on July 26, 1950.

(5) The Function of the Tax Court.

Arthur L. Lawrence, 27 T. C. 713 (No. 82) (January 25, 1957), *now on appeal before the 9th Circuit,* is a Tax Court case involving the statute of limitations. In its opinion, the Tax Court pointed out that its decision might be contrary to an earlier decision of the Court of Appeals for the Ninth Circuit in *Slaff v. Commissioner,* 220 F. 2d 65 (9th Cir., 1955). It justified its position in refusing to follow the *Slaff* case on the ground that, ". . . a court of national jurisdiction to avoid confusion should follow its own honest beliefs until the Supreme Court decides the point."

In this case (*Leh* and *Brown*) the following statement appears in the opinion:

> "If these distinctions are not wholly satisfying, it should be remembered that the Supreme Court was requested to issue writs of certiorari in a number of these cases in order to clarify the situation, but it refused to do so." [R. 35.]

Petitioners suggest, with deference, that the distinctions in the Tax Court's opinion "are not wholly satisfying" because, as applied to the facts in this case, they are incorrect.

If any confusion exists, should it not be resolved in favor of the taxpayers herein—with whom the equities lie? Why should there be capital gain if The Progress Company makes the transaction with a third party and not when it makes the transaction with Olympic?

(6) Conclusion.

The $183,330.50 received by the taxpayers' partnership in this case constituted long-term capital gain.

Prayer.

Petitioners respectfully request that the case be reversed.

Respectfully submitted,

JAMES L. WOOD,

Attorney for Petitioners.

APPENDIX A.

Page References to the Record Where the Exhibits Were Identified, Offered and Received as Evidence.

Joint 1-A Joint 2-B Joint 3-C Joint 4-D Joint 5-E Joint 6-F Joint 7-G Joint 8-H Joint 9-I Joint 10-J Joint 11-K Joint 12-L	)	For Indentification In Evidence Joint Exhibits 1-A to 12-L, inclusive, were attached to and referred to in the Stipulation of Facts in the *Leh* case [R. 15-16, 18], which was identified and received in evidence in page 15 of the Reporter's Transcript, which page was not printed in the Record.
Joint 13-M Joint 14-N Joint 15-O	)	Joint Exhibits 13-M, 14-N and 15-O, not necessary to Petitioners' appeal, were identified and received in evidence on pages 15, 16 and 19 of the Reporter's Transcript, which pages were not printed in the Record.

		Identified	Received
Petitioners' 16	)	60	61
Respondents' P	)	72	74
Respondents' Q	)	74	74
Respondents' R	)	74	75
Respondents' S	)	79	80
Respondents' T	)	109	111

APPENDIX B.

References From Tax Court's Findings of Fact to the Record.

Finding at Page	Paragraph beginning	Source in Record
R. 24	"The petitioners . . ."	R. 6, 12, 19, 21. R. 5, 11, 18, 21.
R. 24	"The Progress Company . . ."	R. 6, 12, 19, 21.
R. 24, 25	"Progress . . ."	R. 44, 45, 52, 65, 66, 67.
R. 25	"Olympic . . ."	R. 15, 101, 102.
R. 25	"On November 19, 1945, . . ."	Jt. Ex. 1-A.
R. 25	"During the years . . ."	R. 102.
R. 25, 26	"On January 28, 1948 . . ."	Jt. Ex. 4-D.
R. 26, 27	"The other letter . . ."	Jt. Ex. 5-E.
R. 27	"Prior to . . ."	Jt. Ex. 2-B; R. 17, 49, 50, 51.
R. 27	"Between . . ."	R. 53, 90, 91, 99; R. 53, 56.
R. 27, 28, 29	"On July 26, 1950, . . ."	Jt. Ex. 8-H.
R. 29	"The amount . . ."	R. 80.
R. 29	"On July 31, 1950, . . ."	Jt. Exs. 9-I and 10-J; R. 93, 97.
R. 29, 30	"In the partnership return . . ."	Jt. Exs. 11-K; 12-L, 13-M.